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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 601.

PAUL W. SAMPSELL, as Trustee in Bankruptcy for the Estate of Wilbur J. Downey, also known as W. J. Downey,

Petitioner,

vs.

IMPERIAL PAPER AND COLOR CORPORATION,

Respondent.

RESPONDENT'S PETITION FOR REHEARING.

HIRAM E. CASEY,
535 Rowan Building, Los Angeles,
Attorney for Respondent and Petitioner.

HORACE W. DANFORTH,
Of Counsel.

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To Charles Evans Hughes, Chief Justice, and the Associate Justices of the Supreme Court of the United States:

The respondent in the above entitled cause respectfully petitions and prays that the said cause be reheard and redetermined after judgment rendered herein, which said judgment was filed April 28, 1941, the time for filing this petition having been duly extended by order of court to and including May 29, 1941. The said opinion is now reported in 85 L. Ed. (Adv. Ops.) 797.

Petitioner's application for such rehearing and redetermination is based in particular upon the following grounds submitted, to-wit:

FIRST, That the court has inadvertently misconceived the content of the record in this particular case, and therefore, in making a statement of fact to support its opinion, it has obscured the detail of many of such facts, and also has neglected other facts in the record, which, nevertheless, are vital and controlling in this case.

SECOND, That by reason of this treatment of the facts, the decision of the case has been made to rest upon the stated conclusions that: "But in this case there was a fraudulent transfer"; and that, "Furthermore, respondent had at least some knowledge as to the fraudulent character of Downey's corporation"; but the details of fact, in the record of this particular case, upon which these conclusions are conceived to be based are not stated.

THIRD, That further by reason of the above noted treatment of the facts, while the opinion concedes that courts of bankruptcy have power to regulate claims and adjudicate equities, and that, under proper circumstances, the rights of creditors of even a fraudulent transferee, may be protected in their rights by equitable considerations, or by estoppel, the opinion declares that: "None of these considerations is applicable here", but does not state how or why this conclusion is to be arrived at upon the detail of the record facts in this particular case.

FOURTH, That by reason of all of the foregoing, and further by reason of the various holdings announced, the opinion in form and effect appearing serves to unsettle and confuse, rather than clarify the "administration of bankruptcy law", in particular in regard to the effect, as

res adjudicata, of a referee's order upon the rights of one not a party to the proceeding in which the order was obtained, and also as respects the effect of local decisions in matters of local law, such as questions of equitable lien on personal property, and the effect of *alter ego* upon a corporation and its affairs; and further, unsettles the status of the creditors of a fraudulent transferee.

In support of this petition and application, petitioner relies upon the record in this case, and the briefs already on file herein, and upon the considerations and authorities set forth in the argument appended hereto.

Respectfully submitted,

HIRAM E. CASEY,

Attorney for Respondent and Petitioner.

I Hiram E. Casey, the attorney of record in the above entitled cause, hereby certify that this Petition for Rehearing is, in my judgment, well founded, and it is not interposed for delay.

HIRAM E. CASEY,

Attorney for Respondent and Petitioner.

Dated: May 27, 1941.

ARGUMENT.

Introductory Summary.

"If at first you don't succeed, try, try again!". That maxim may be old fashioned;—but, it is most respectfully submitted, it expresses the essence of all human experience, —even in proceedings in court. Notwithstanding the apparently unanimous opinion of this Honorable Court in this case, respondent and petitioner feels constrained to ask rehearing thereof. It feels this constraint, because it is eternally convinced of the rectitude of its positions, and the validity of its contentions, which have at all times been maintained in this controversy. It further feels this compelling urge, from the very form and content of the opinion itself. It is most respectfully submitted, that such opinion is very brief indeed, for the purposes it undertakes; and that its statement of facts, and their application to this case in the light of legal principles declared and accepted, is condensed and foreshortened to the last degree. It is further most respectfully submitted that the opinion in form appearing serves to confuse rather than to clarify the "administration of the bankruptcy act", especially in the particulars hereinafter to be noted.

This case has indeed traveled far, since first it entered upon its course. It initiated in respondent's claim as a creditor of the Downey Wall Paper and Paint Company, a corporation, with a petition for its preferential payment out of certain proceeds in the hands of the trustee, derived from assets taken from the said corporation. [Tr. 7-18.] This claim and petition were based upon the claim of an equitable right or lien arising out of respondent's dealings with said corporation, which were specifically averred to have been the delivery of goods to the corporation in

good faith, and in the due course of business. The claim and petition were opposed by the trustee on the *sole* grounds that: such was not a "prior claim" under Section 64 of the Bankruptcy Act; and that respondent had or claimed no lien "on assets of the said bankrupt estate", and was a mere unsecured creditor. [Tr. 18-19.] Respondent's allegation of good faith and due course of business was not traversed, and was therefore necessarily admitted in the pleadings.

The case now stands disposed of here upon the twin conclusions: that it is somehow affected by "a fraudulent conveyance"; and that the respondent is fatally chargeable therewith by reason of "at least some knowledge as to the fraudulent character of Downey's corporation", although the facts and circumstances deemed to warrant these conclusions are not made to appear.

In the interim, the case has become encumbered by a number of successive considerations which have been interjected by the trustee from time to time. These respondent has met in his several briefs as the occasion required. At present, "Section 64 of the Bankruptcy Act" has dropped out of the picture.

It is most respectfully submitted that, irrespective of all else, in disposing of this case, two separate states of fact—undisputed and indisputable in the record in this particular case [Tr. 39-67]—must at all times be borne in mind. First of these is, that, before it would have any dealings whatever in which Downey should be at all involved, respondent demanded that a separate entity, a corporate body, should be created with which, and not Downey, it could deal in regard to its particular products [Tr. 58]; that respondent did not demand the conveyance of any

assets to such corporation before it would deal, nor was it interested that the new entity should have any assets other than those which respondent itself might place in the hands of such corporation [Tr. 43-44]; that respondent was not even aware of any contemplated or proposed transfer to such corporation in *1936* of that *portion* of Downey's business which represented wall paper and paint, until after the same was already arranged for [Tr. 50-55]; that after the said corporation had been actually organized, respondent dealt with it exclusively, for a period of about two years; that the business so done aggregated upwards of $50,000 [Tr. 60]; that all of the same was handled, accounted for, and settled for, exclusively with the said corporation [Tr. 60]; that about $5400, representing the last business done, formed the basis of respondent's claim and petition; that, of the assets taken by the trustee in bankruptcy, at least the major portion was property which respondent had delivered to the corporation in the course of the business above mentioned; and that, at the time of Downey's bankruptcy, respondent was the *sole* creditor of the corporation. [Tr. 60-61; 35.]

In the second place, it is undisputed and indisputable that, with knowledge, both actual and constructive, of the conveyance of that portion of Downey's assets which represented wall paper and paint, Standard, which in June, 1936, was the *sole* creditor of Downey [Tr. 50, 54], did nothing whatever, and did not object to or complain of anything—much less to obtain a judgment against Downey upon its claim—until in the fall of *1938;* that, on the contrary, it received and accepted, by its own statement, more than $20,000 to apply on account of its claim and the interest thereon [Tr. 181]; that furthermore,

during that said time, it had further dealings with Downey, on account of the particular line of goods which it had to sell and dispose of and which Downey had contracted with it to sell; and that a remainder of these later transactions is represented by a claim of $4,101.14 filed against the individual, Downey, in his bankruptcy. [Tr. 128-136.]

It is most respectfully submitted that these two factual situations which, it is furthermore respectfully submitted, can not be escaped from on the record in this particular case [Tr. 39-67], not only justify the claim and petition which respondent originally made against the funds from the property taken by the trustee in bankruptcy, but also require that the present opinion in this case be so far modified as to affirm and not reverse the judgment of the Circuit Court, which latter judgment reversed the judgment of the District Court.

In its briefs, as well as on the oral argument before this Court, respondent sincerely believed that it had made all these things clear. It now appears that, unfortunately it failed in some manner to do so. To correct this mischance, the present petition is tendered, and in its support are offered the considerations now to be made, under the successive propositions which will be set forth. Furthermore, the court's attention is again most respectfully invited to the matters and considerations set forth in its former briefs herein.

Hereinafter, for the sake of clarity, the parties will be designated as the trustee, meaning the petitioner for certiorari; and as petioner, meaning the petitioner in the present petition, the respondent in the certiorari. Any emphasis appearing will be supplied, unless otherwise credited.

I.

The Opinion's Statement of Facts, and Heading Numbered 1, as Compared With the Record in This Case.

Pursuant to the first ground stated in the petition, and as a foundation and point of departure for subsequent considerations, the statement of facts made in the opinion will now be analyzed. (85 L. Ed. (Adv. Ops. 798-799).)

1. The statement shows the date of bankruptcy (November, *1938*), and of the incorporation of the Downey Wall Paper and Paint Company (June, *1936*); but,

Does not note the lapse (more than two years) between the two dates mentioned; and, thereafter, in the opinion,

No significance whatever is ever attached to such lapse of time, and it is not even mentioned.

2. The statement notes a debt of the Standard Company, *prior* to June, 1936, for which Downey, individually, was responsible; but,

Does not note that such was his *sole* debt in 1936; and,

Does not note that between 1936 and 1938 Standard admitted receiving more than $20,000 on account of its debt, and the interest thereon. [Tr. 181.]

3. The statement notes the incorporation of the Downey Wall Paper and Paint Company; but,

Does not note that it functioned uninterruptedly until April, 1939.

4. The statement says "Downey's stock of goods was transferred to the corporation"; but,

Does not note that this "stock" was only a *part* of Downey's business, that is his business in wall paper and paint; and,

Does not note that this is *not* the part of Downey's business which included the handling of Standard's products under his contract, that is the Sanitas, oil-cloth and leather cloth products;

Does not note,—in the footnote reference No. 1,—that the "notice", "recorded under the California Bulk Sales Act" [Tr. 56-57], specified the consideration of the sale to be made, and that such was a promissory note in the amount of $7500;

Does not note that Standard had both actual and constructive notice of the transfer of the portion of Downey's business above mentioned.

5. The statement says that the transfer was "on credit, which was extended from time to time", and thereafter the statement designates the consideration of the transaction as an "obligation"; but,

Does not note that this "credit" was, in point of conceded fact, a promissory note, stated in the aforesaid "notice recorded", to be of the amount above mentioned;

Does not note that the "some dispute", mentioned in footnote No. 4, was only in the argument and not in the record, and was not whether there was or was not a promissory note, but only as to the amount of the note conceded to have been given; and,

No significance is attached in the opinion to the fact that a promissory note was given.

6. The statement says that after it "leased space in the building occupied by him" (Downey), "the corporation continued business at the old stand"; but,

Does not state that the business "continued" was only a *part* of the business Downey had theretofore done; or,

That such "continued" business was kept and accounted for wholly separate and apart from Downey's business in which the creditor Standard was interested; and,

Does not state that the aggregate of the business thus "continued" aggregated upwards of $50,000 in the time it was continued.

7. The statement says, in footnote No. 3, that "on *July 1, 1938,* Downey transferred ninety-nine shares of the capital stock of the company from himself to other parties in his family"; but

No significance is attached in the opinion to the *date* when this transfer of stock occurred, with reference to the *time* of the transfer of a *part* of his business in 1936.

8. The statement says that: "Respondent extended credit to the corporation"; but,

Fails to note that during the period between *1936 and 1938,* the amount of that "credit" had aggregated twenty-two or twenty-three thousand dollars per year for goods which the respondent had delivered

to the corporation, and that respondent's claim of "about $5400" represented the balance remaining unpaid at the time of Downey's bankruptcy [Tr. 60-61];

Does not note that the evidence is [Tr. 60-61], and the referee found expressly in this particular case [Tr. 35], that respondent was the *sole* creditor of the corporation at the time of bankruptcy;

Does not note that wall paper thus delivered to the corporation by respondent, represented at least the major portion of the assets taken by the trustee and subsequently sold;

Does not note that any property received by the corporation in the transfer from Downey in 1936 had all been previously disposed of in the course of the corporation's business. [Tr. 61.]

It is most respectfully submitted that when the details supplied by the comments just made in reference to the opinion's statement of facts are taken into consideration, as it is submitted they should and must be, a far different picture emerges from the record in this case than that which the opinion manifestly contemplates. It is further respectfully submitted that the record sustains all of the observations made without any dispute. Indeed, the trustee himself supplied most all of them by the evidence he adduced on the hearing in this particular case.

In a paragraph on page 798 of the L. ed., *supra*, the opinion further states the proceedings leading up to the order of April 7, 1939; and there summarizes the terms of that order.

In the next paragraph, appearing on page 799, the opinion states the proceedings in the present case, which

ultimately brought the matter to this court. It is respectfully submitted that the *two* proceedings, and the *two* orders, must at all times be borne in mind as wholly separate and distinct.

In the paragraph last mentioned, it is noted that respondent "was not a party to *that* proceeding" (the one leading to the order of April 7, 1939).

Also, it is noted that respondent's claim was "as a creditor of the corporation", to "a prior right to distribution of the funds in the hands of the trustee received from the liquidation of the assets of the corporation"; but,

> Does not note that respondent based its claim on the ground of an *equitable lien or right,* as a charge on the property taken by the trustee and sold, which lien or right was claimed on account of goods respondent had sold and delivered to the corporation in good faith and in the due course of business. [Tr. 8, 9; 14-15; 16-17.]

Also in the same paragraph, it is noted that the "trustee objected to the allowance of the claim as a prior claim and contended it should be allowed only as a general unsecured claim"; but,

> Does not note the trustee's objection to "a prior claim" was based solely on Section 64 of the Bankruptcy Act [Tr. 19];
>
> Does not note that the trustee's objection to the claim as secured was solely that respondent had no lien on "the assets of the *bankrupt estate*" [Tr. 19];
>
> Does not note that the trustee did *not* challenge the "good faith", or the "due course of business" of respondent's dealings with the corporation during any of the time involved.

In the same paragraph, the opinion further states the referee's findings in the present case, after the "hearing" had therein, and states these findings to be, "that Respondent with knowledge of Downey's indebtedness was instrumental in getting him to form the corporation and had full knowledge of its fraudulent character";

> Does not note that this confuses the manner of the transfer of 1936 involving property belonging to Downey, with the organization of the corporation itself under the permission and fiat of the State of California;
>
> Does not note that nowhere has the *corporate existence* ever been challenged or questioned, by anybody.
>
> Does not note the stated facts, that the transfer was after recorded notice under the California Bulk Sales law, and upon a consideration delivered;
>
> Does not note that two-third (99 shares) of the corporate capital stock was not issued until July 1, 1938, *after* respondent's dealings with the corporation were virtually completed.

In this connection, it has never at any time been claimed or contended by the trustee that, for any reason whatsoever, the corporation failed to become, and to exist and function, as a complete lawful legal entity. The only thing he contended for has been that the *transfer* by Downey to the corporation was characterized by fraud, in which fraud respondent was a participating party. This contention has

always been vigorously repelled, on the facts. The court is earnestly urged to consider the respondent's brief filed here, particularly at pages 7, 11, 24.

The opinion further states the confirmance of the referee's order, and the Circuit Court's reversal thereof.

The opinion then states that: "We granted the petition for certiorari because of the importance in administration of the Bankruptcy Act of the question raised".

HEADING NUMBERED "1" IN THE OPINION.

The remainder of the opinion proceeds under two main subdivisions, designated 1 and 2. Under 1, the opinion considers the matters set forth in its statement of facts particularly relating to the order of April 7, 1939. It reaches the conclusion that such an order was justified in view of the facts found by the court in the proceeding, and concludes that the same could not be *"collaterally attacked* in the proceedings by which Respondent sought priority for its claim".

It is most respectfully submitted that at no stage of the present proceedings was it, or is it now, sought to *attack,* collaterally or otherwise, the order of April 7, 1939. The position always has been, and it now is, that *as to this respondent,* and as to any of its rights in the premises, that order had *nothing* whatever to do. The position, in effect, has always been that assuming the proceedings were binding as between the parties thereto, and further assuming that the order made therein could be justified, so far as

those parties were concerned, such was true *only* as to the *parties* there specifically concerned, and affected the *respondent not at all*—except to explain why, after and by virtue of the orders entered on April 7, 1939, the trustee had seized and thereafter sold the property found in the hands of the corporation, respondent proceeded against *him*. It's clearest and most available remedy, lay in its claim against the funds in the hands of the trustee as aforesaid, based upon the preferential right of respondent, as a creditor of the corporation solely, to payment out of the said proceeds, *before* any application thereof should or could be made in the estate of Downey, the individual. Respondent did not waive or prejudice any of its rights by resorting to the bankruptcy court.

In re Plattville etc. Co., 147 Fed. 821, 831;
In re Zitron, 203 Fed. 79, 82.

Under heading 2 of the opinion, this position of respondent is indeed conceded by the court. It is said (page 799):

> "That conclusion, of course, does *not* mean that the order consolidating the estates did, or in the *absence* of the Respondent as a party, *could* determine what *priority*, if any, it had to the corporate assets."

This could not well be otherwise. Not being a party, necessarily it could not be bound—either by the order itself, or by any of the proceedings leading thereto, considered as *evidence* of any facts purporting to be established thereby. This could not be otherwise, for the fundamental reason that nothing such could be *res ad-*

judicata against respondent. The opinion itself cites authority to this effect (*re Foley*, 4 Fed. (2d) 154). The whole ground in this connection is well stated as follows:

> "Every man is entitled to his day in court, to conduct his own trial, produce his own evidence, examine the records, and cross-examine the witnesses, and this should never be done by someone whom he has never selected and who may have a different status in the controversy."
>
> *Women's etc. Foresters v. The City of Arlington*, 28 Fed. Supp. 663, 664 (3).

Until such a situation is disclosed in any particular case, any existing judgment or order can never be *res adjudicata*.

In the *Foresters'* case, *supra*, the plaintiff was held entitled to litigate, independently, the *fact issue* of the city's inability to pay its bonds in full, which issue had previously been *adjudicated*. So, should the respondent here be entitled to the determination of *its* rights, unaffected and uninfluenced by anything emanating from the order of April 7, 1939.

It is not and never has been conceived that any reference whatsoever to the proceeding of April 7, 1939, or the orders made and entered therein, of the findings upon which that order was based, could have any bearing whatsoever upon anything involved in this present proceeding, except to show why respondent was in bankruptcy court. That order, and anything whatsoever leading thereto, was, as to this respondent, wholly *res inter alio acta*. Being

such, it can afford no *evidence* either for or against it. Therefore, particularly at the present stage, it should not, the respondent respectfully submits, be brought into juxtaposition with the claim and contentions of respondent. However incompetent it may be to bind the respondent, however much it may be *said* that it *"could not* determine what priority, if any", the respondent had—nevertheless the premises of the order itself, and the very voluminous findings the referee was led to make, may well have, it is most respectfully submitted, a psychological if not a legal effect. The clang of the court's language, announcing its findings and judgment, must ring in the ears of anyone to whose attention they might come, and might well serve, even unconsciously, to supply an impetus and impulse toward a determination in the case of this respondent which would not otherwise be arrived at.

But, however this may be, upon the face of the opinion now appearing, it still remains that the court has determined and held that the order of April 7, 1939, is *not* binding upon this respondent. That, it is submitted, is all that the respondent has ever at any time contended. It is therefore further submitted that the order, or any reference to its contents and antecedents, is inappropriate in an opinion disposing of the respondent's rights.

With this much of consideration of the opinion's statement of fact, and of its heading number 1, the remaining matters will be considered under three successive heads, which are indicated in the foregoing petition herein, under "Second", "Third" and "Fourth".

II.

As to This Respondent, a Fraudulent Conveyance by Downey to the Corporation in 1936, if Indeed There was Any Such, Would, in Any Event, Be an Immaterial Circumstance; and the Record in This Case Conclusively Establishes That Respondent Had No Knowledge of Anything That Would Charge It With Any Fraud in Any of the Transactions in Question.

As set forth in "Second" of the petition, the opinion rests its reversal of the judgment in the Circuit Court, and the affirmance of that of the District Court, on the ground that this case involves a "fraudulent conveyance", and that respondent "had at least some *knowledge* of the *fraudulent* character of Downey's *corporation*". It is submitted the language, "fraudulent character of Downey's corporation", is certainly inexact, and therefore misleading. It is submitted, nothing is made to appear that should in anywise indicate that there was anything whatsoever fraudulent, or even defective, in the organization of the corporation under California law; or that, for any reason, any difficulty or obstacles were ever encountered in its functioning as a corporation, prior to the interference with its assets by the trustee's action under the bankruptcy. It is assumed that what was intended by the phraseology is, that the corporation, and the organization thereof, were a part of means devised by Downey to assist him in making a fraudulent conveyance of a part of his assets.

It is most respectfully submitted there is not anywhere in the record the slightest evidence to establish, or even to indicate, that anything such was the fact. To the contrary, all of the evidence bearing upon the subject matter of the organization of this corporation establishes beyond any dispute that the *corporation* was organized by Downey solely, wholly, and entirely to comply with the condition fixed by the respondent as being the one necessarily *precedent* to its doing any business with Downey whatsoever. Respondent desired, as the record establishes, to employ Downey's services and ability in marketing its particular product in Los Angeles. But it would not consent to so employ him, or to have any dealings whatsoever with him, until he should have established an entity which would insulate those transactions from Downey's own personal business—in the previous course of which, and under his partnership with another, he had become subject to a very heavy indebtedness to Standard, through handling the sale and distribution of its products. In compliance with this demand, the Downey Wall Paper and Paint Company was formed. It was *no part* of the respondent's desire or demand that Downey should *transfer* to the corporation his personal business or assets, or any part thereof. Respondent did not know that anything such was contemplated or intended, *until—after* the fact—he was advised by Downey's attorney that such was indeed *in fieri*. It is respectfully submitted that a man still has a perfect legal right to select and determine the type of entity with which he will do business. In this case, respondent did nothing

more, and the record, when fully comprehended, establishes this beyond peradventure.

Manifestly the conclusion of respondent's "knowledge as to the fraudulent character of Downey's corporation" rests solely on the referee's finding [Tr. 34, last paragraph], whose language it closely follows. But, as just set forth, this particular finding is not supported by the evidence produced in this proceeding. [Tr. 40-44.] This finding is further vitiated by the fact that it actually rests upon the findings and order of April 7, 1939, which the referee, by "judicial notice" [Tr. 23], but without legal justification, undertook in his "Certificate on Review" to import into the present proceeding. [Tr. 26.] It is again respectfully submitted that the actual record in this case charges respondent with *nothing* of "knowledge" of *anything* "fraudulent".

So far as Downey's transfer to the corporation is concerned, viewing it as a transaction involving this respondent and its rights, and disregarding—as the present opinion concedes must be done—any prior adjudications in the bankruptcy court, which are not *res adjudicata* as to respondent, it is respectfully submitted that there is absolutely nothing in the record in this case to establish that Downey's transfer of his wall paper and paint business to the corporation he had organized was fraudulent, either in fact or in law. It is conclusively established, and is not denied by anybody in connection with this case, that before Downey undertook to make any transfer whatsoever of anything, he took the utmost pains to comply with

the California Bulk Sales Act. For the time required, and in the terms required, he recorded a notice of what he would sell, what he would receive in consideration of this sale, and the time and place of its occurrence. It is nowhere contended that this notice, recorded as required by the then existing Civil Code, Sec. 3440 (third paragraph: "Bulk Sales"), did not comply fully with all of the requirements of that law. Neither is it denied that, in accordance with the notice, the sale was actually effected, the consideration delivered, and the goods taken over by the corporation. Furthermore, the evidence in this case is undisputed and indisputable that the property so delivered to the corporation was by it actually taken over into its own peculiar possession and dominion. The only evidence bearing upon that issue establishes that, although a part of the same building in which Downey still carried on the *rest* of his business—the part which involved Standard—was occupied by the corporation, still that occupation and its attendant circumstances, by the uncontradicted testimony in this proceeding, is that those assets and that property were at all times wholly segregated from any assets and property which either belonged to Standard, or was held by Downey, as an individual, and employed by him in the continued conduct of his *individual* business. Still furthermore, since, as just stated, a promissory note was advertised as the consideration of the sale, and was actually delivered in consideration of the wall paper and paints transferred, there was a complete valid legal consideration for that sale, and the same is not

properly designated as a sale on "credit". Promissory notes are sufficient consideration for a conveyance by a debtor. (27 *C. J.* 528, Sec. 212, Note 62.)

For the first time in this case, "a fraudulent conveyance" plays a major role. Heretofore, it has had only a minor part, and the various contentions of the trustee were met in the terms presented. Such has always been treated as immaterial, particularly in view of all of the acts and conduct of the then sole creditor, Standard, for more than two years after the sale. (*Cf.* Respondent's Brief, p. 24, *et seq.*)

It is respectfully submitted that Downey's transfer in 1936 cannot be questioned here, in any event; and that, upon all the facts, respondent's rights were never affected thereby. It was not any party in interest *in* the corporation. Its only relation thereto was to deliver goods *to* it, and collect their purchase price. It had no interest in the property transferred, and derived no benefit therefrom. All such property had passed away from the corporation, *before* the advent of any question or right here involved. It is submitted that this is so, for reasons independent of estoppel.

Admittedly, the transfer conformed to the California Bulk Sales law, and was upon consideration. Under general law, though indebted, Downey had the right and power to make the sale (*Civil Code*, Sec. 3431), and this right was confirmed by the Bulk Sales law (*Civil Code*, Sec. 3440, "Bulk Sales" proviso). Under this, transactions

affected by it are good as between the parties and all in interest under them, respectively. All such are informed by the recorded notice, and are therafter governed accordingly. (*Markwell & Co. v. Lynch,* 114 Fed. (2d) 373, 374 (3).) There, the law had not been complied with, and the consequences were declared, with reference to California decisions.

If the notice *is* given, "existing creditors" who are *unsecured* have, by the notice, right and opportunity to "protect themselves". Such right is necessarily a privilege which may be waived. The creditor may be satisfied with the transaction, and acquiesce therein. As elsewhere, he will so acquiesce and waive, if such is the legal effect of his subsequent acts and conduct. (*Kennedy v. Georgia State Bank,* 8 How. 586, 613.) In the present case, the record facts show Standard *acquiesced in and sanctioned* the transaction of Downey—so long as it was receiving benefits. This is best evidenced by its failure, during more than two years, to obtain any judgment on which it *could* question the sale. The sale was a perfectly good sale, and Standard, conclusively, so considered and treated it. Furthermore, it is said that a transfer such as this, to a corporation such as this, does not involve a fraudulent conveyance at all. The capital stock was kept practically intact, until July 1, *1938.* (Glenn, Liquidations, Sec. 28, citing Glenn, Fraudulent Conveyances and Preferences, Secs. 286, 417.) This would be particularly so, if the transfer is duly made and its notice recorded according to law.

As to parties *subsequently* dealing with Downey, and becoming *his* creditors, *all such* were advised by the recorded notice they could no longer look to what he had sold. Such a record notice runs to "all the world". (*Thompson v. Fairbanks*, 196 U. S. 516, 527, 49 L. ed. 577, 587.) Such is its purpose.

To summarize, since it is conceded that respondent is not bound by the terms of the order of April 7, 1939, it must follow that in the prosecution and determination of its own right, it is to be permitted to determine such upon the evidence in its own case, as though the other proceeding had never been held, and as though no such order and its inducing findings had ever been made. Thus it appears that respondent's enjoyment of his rights under this principle is not an attack upon the order of April 7, 1939, either direct, collateral or otherwise. It is merely the recognition of his right to *his* day in court, to litigate the issues involved in respect to his own rights, upon such facts as may then be made lawfully to appear. In this connection, the fact must not be lost sight of that in the original hearing in this case, upon the objections filed by the trustee and the issues tendered thereby, no issue of fraudulent conveyance was interposed, litigated or determined. Further, the order of April 7, 1939, was not even offered in evidence on the hearing, though it was referred to, to test the witness, Downey. [Tr. 43.]

It is finally submitted that, upon all of the facts presented by the record in this proceeding, the court's conclusion in its opinion is neither justified nor sustained.

III.

Upon the Facts in This Record, the Respondent's Rights, as Recognized and Vindicated by the Judgment of the Circuit Court, Are Fully Established Upon the Basis of an Equitable Lien on the Assets of the Corporation, and, in Any Event, by the Estoppel of Any Creditor, and of the Trustee as His Representative, to Question Those Rights.

The matter of this proposition is expressed in the "Third" specification in the petition. The opinion concedes that *"bona fide* lien creditors of the fraudulent transferee" may still be protected, and further concedes that "estoppel or other equitable considerations", would bring about the same result (p. 800). The court cites various cases which establish the principle under varying circumstances. The opinion finally states that: "Yet none of these considerations is applicable here. The facts do not justify the invocation of estoppel against Downey's individual creditors. Respondent is neither a lien creditor nor *innocent grantee* for value" (p. 801). It appears, however, that the court does not marshal any items of evidence to support these holdings. But it ultimately appears that the result is conceived to rest upon the respondent's "knowledge" as to the "fraudulent character of Downey's corporation", which has hereinbefore been considered.

In support of the matter of respondent's "knowledge" the court refers to two California cases, *"Cf. Goodwin v. Hammond,* 13 Cal. 168, 73 Am. Dec. 574; *Bull v. Ford,* 66 Cal. 176, 4 Pac. 1175". These cases both rest upon

actual fraud and collusion to defeat creditors, and involve the *transferees* directly, with the possibility that such transferees were merely voluntary. It is not understood how these cases, or their principles, could have bearing upon a case such as that of respondent here. Here, the conveyance whatever else it was, was upon adequate consideration. Here, there was, first, no actual intent on the part of the grantor to do anything other than to enable himself to engage in a business which presented another prospect of lucrative returns, and which might thereby, and in point of fact, actually benefit his then existing sole creditor, Standard. Here, respondent was *no party the the transfer*. It had no interest whatsoever in the grantee corporation, other than as its subsequent vendor and creditor—*after* it had begun to function. Here, the respondent, after demanding the entity, furnished it goods and extended credit, to an amount upwards of $50,000, the remaining portion whereof constitutes the basis of its claim. Respondent never demanded any transfer of assets.

Again, it is not perceived how the principles of the cited cases can be applied to a state of facts such as the foregoing.

In the opinion, as has been noted, the court cites *Re Foley*, 4 Fed. (2d) 154, as vindicating the rights of a creditor to first access to the assets of its debtor corporation, bankruptcy intervention notwithstanding. It is respectfully submitted that the facts of that case do not as closely parallel those of the present case as do the facts of cases heretofore cited in respondent's briefs. (*Hurley*

v. A. T. & S. F. Co., 213 U. S. 126, 132-133, 53 L. ed. 729, 733; *Carroll v. Stern*, 223 Fed. 723, 725; *In re Alleman Hdw. Co.*, 158 Fed. 119, 120, 121; *U. S. F. & G. Co. v. Sweeney*, 80 Fed. (2d) 235.) (*Cf.* Respondent's brief, pp. 20-23; 27-30.)

It is further submitted that the court's recognition of "equitable considerations" is exactly exemplified in the foregoing cases. Respondent's arrangement with Downey for a corporate entity with which it would deal exclusively is submitted to be the precise equivalent of the contract arrangements in the *Hurley* and *Sweeney* cases, *supra*. Regarding the possibility of an "estoppel" precluding the trustee's claims, which is also conceded in the opinion, it is respectfully submitted that the record facts establish each and every essential element of an estoppel *in pais*. Such principles are universal, and well recognized. (*Monroe v. Ordway*, 103 Fed. (2d) 813, 814; *In re Thornton*, 7 Fed. Supp. 613, 614 (2, 3); *In re Allee*, 55 Fed. (2d) 76, 78 (7); *McDaniels v. General Ins. Co.*, 1 Cal. App. (2d) 454, 459-460 (3, 4, 5).)

It has hereinbefore been noted, with reference to this record, that with full knowledge of the conveyance which Downey had made, Standard delayed for more than two years, before it made any complaint, lodged any objections, or did anything whatever toward the assertion of its claim. It did not even put its claim in judgment, which it necessarily must have done before it could competently challenge the Downey transfer. Instead, and still in full

knowledge, it received and accepted substantial benefits by reason of expanded operations of Downey, and of Downey's company, such substantial sums aggregating in excess of $20,000. During the same period of time, in reliance upon the conditions as they existed, and upon its contract with Downey for dealings with the corporation exclusively, respondent delivered goods and advanced credit as has hereinbefore been noted.

Regarding the consequences of such conduct on the part of a party having, or claiming to have, a right which he could assert, and which, if asserted, would materially alter, if not entirely destroy, the basis upon which respondent was relying and acting. The principles are fundamental, elementary and universally recognized.

This court has said, none can "take the benefits", "without the burdens". (*Consolidated etc. Co. v. Du Bois,* 85 L. ed. (Adv. Ops.) 603, 611 (11).) Everywhere the rule is recognized and applied. "The creditor who asserts a fraudulent conveyance *must act* if he is to make his claim good". (*Glenn, Fraudulent Conveyances and Preferences,* Section 238.) "A's (fraudulent transferor) creditors *could* have set the conveyance aside in the beginning; but, as they did not, it remained a consummated transaction as between the two parties". (*Glenn, supra,* Section 122 (123).) (*Cf. McDaniels v. General Ins. Co., supra.*)

It is most respectfully submitted that the creditor Standard could never escape from a charge of laches in this case, and an estoppel results against any challenge of any rights of respondent. The opinion's denial of the application of that doctrine, upon the present facts, is indeed grievous error.

IV.

The Opinion Serves to Render Confusing the "Administration of the Bankruptcy Law", in Particular as Regards a Referee's Order as Res Adjudicata, and as Regards the Effect of State Decisions, Especially in Relation to a Creditor's "Equitable Lien", and the Effect of Alter Ego on a Corporation's Affairs.

This relates to "Fourth" in the petition.

The opinion says a referee's final order, in a proceeding where respondent was no party, "could *not* be *collaterally attacked* in the proceedings by which respondent sought priority"; then says such "conclusion, of course, does *not* mean that the order, * * * in the *absence* of the respondent as a party, *could determine* what priority, if any, it had to the corporate assets"; and then holds, respondent had *no priority*—upon a state of facts, which, it is respectfully submitted, could not sustain the final holding, without giving effect to the factual basis of the referee's final order. In other words, the referee's final order *is*, after all, *allowed* to "determine" the "priority"; and the announced immunity to "collateral attack" is applied, despite respondent's right to its "day in court". It is submitted this result is unfortunate in the administration of the law; not to mention its disastrous effect on the rights of respondent.

It is accepted doctrine that local decisions, on local law, are controlling in this court. In California, it is established that: "In equity a *lien* consists in the right to *subject* the property, even though *not* in the possession of the lienor, to the payment of the *debt or claim*, as a *charge* on the property. * * * A merely *verbal* agreement may

create *such a lien on personal property*". (16 *Cal. Jur.* Sec. 10, pp. 307-308; *Hall v. Cayot,* 141 Cal. 13, 18-19; *White v. White,* 11 Cal. App. (2d) 570, 574.) (*Cf.* Respondent's brief, p. 15, *et seq.*) Here, respondent had dealt with the corporation under an arrangement and agreement with Downey, that the corporation should always be its *sole debtor,* to which alone it could and would look for payment and security. This agreement and arrangement was strictly carried out. At the time of the bankruptcy, respondent was the corporation's *sole creditor,* and very much of the corporation's then assets had come from respondent. It is respectfully submitted that the California doctrine, if applied here, fully sustains respondent's priority; and to deny it application, impugns that doctrine, and refuses it recognition. It is further respectfully submitted any theory of "affiliation" finds no place in the picture of this case.

In California, even though a corporation is held the *alter ego* of an individual, its separate legal existence under fiat of state law is not to be disregarded, unless and until it is shown that to recognize its separate existence would "promote fraud, defeat justice or produce inequitable results". (*Erkenbrecher v. Grant,* 187 Cal. 7, 11 (2); *Hollywood etc. Co. v. Hollywood etc. Service,* 217 Cal. 124; *In re Sterling* (C. C. 9), 97 Fed. (2d) 505.) It is submitted that, on the facts of this case, showing the relative situations and conduct of Downey, Standard and respondent, there is no ground, under the California doctrine, for disregarding the entity of the corporation, in aid of Downey's estate and its creditors, to the exclusion of the prior rights of respondent. Rather, if such is done, respondent is deprived of the benefit of a lawful arrangement effected for

its protection, justice to it is defeated, and grave injury to its interests is done. Fraud does not enter in. The opinion here holds that respondent must suffer all these things. It is submitted that this holding also impugns California doctrine, and denies it recognition in this court.

Conclusion.

It is surely still the law that one still may choose the entity with whom he will deal; that, when he has made a selection of such entity, and has thereafter scrupulously abided by his election, any rights which may have accrued to him in the course of his dealings, must be recognized and held to be against that entity alone; and that, if need be, his rights through such dealings—particularly as against property and its proceeds which his dealings have placed in the hands of the entity—must first be awarded to him, before any third parties' claims can enter in. As to him, even though the entity selected be corporate and even though, in general, it might be regarded as the *alter ego* of another party, still as to the limited, segregated and indeed contractually delimited course of his dealings, such a one must still be preferred as against creditors of the other party whose *alter ego* the corporation is. If this is not so, then the rights from the contract are denied, and under circumstances where no question of public policy enters in. The opinion in this case states that: "Equality of distribution", is "the theme of the Bankruptcy Act". This is indeed true, but it is respectfully submitted that that "theme" applies *only* as between creditors of the bankrupt and his bankrupt estate, and never as between third parties. Upon all of the facts presented in this case, respondent was never the creditor of Downey. At all times it re-

fused to become such. And its acts and conduct accorded with its original understanding and agreement with Downey, that it should never become *his* creditor. It is submitted that these considerations, coupled with those dealings, establish an equitable lien, show the disablement of Standard, and of the trustee in bankruptcy, to challenge respondent's rights. But, also, they render the present decision in this case grievously erroneous as to respondent. No escape from this is to be afforded by the fact that there were claimants against Downey's individual estate for claims current in the year *1938*. Such were all creditors with notice, under and by virtue of the *notice* given through the record of the "bulk sale" made by Downey in 1936. (*Markwell & Co. v. Lynch* (C. C. 9), 114 Fed. (2d) 373, 374 (3).) Such was notice to "all the world". (*Thompson v. Fairbanks, supra.*)

It is most respectfully submitted that a rehearing should be granted in this case, in order that the errors hereinbefore complained of may be examined and corrected.

Respectfully submitted,

HIRAM E. CASEY,
Attorney for Respondent and Petitioner.

HORACE W. DANFORTH,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES.

No. 601.—October Term, 1940.

Paul W. Sampsell, as Trustee in Bankruptcy for the Estate of Wilbur J. Downey, Also Known as W. J. Downey, Petitioner,
vs.
Imperial Paper and Color Corporation.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[April 28, 1941.]

Mr. Justice Douglas delivered the opinion of the Court.

One Downey was adjudged a voluntary bankrupt in November, 1938. Prior to June, 1936, Downey had been engaged in business, unincorporated, and had incurred a debt to the predecessor of Standard Coated Products Corporation of approximately $104,000. In that month he formed a corporation, Downey Wallpaper & Paint Co., under the laws of California. Downey, his wife and his son were the sole stockholders, directors and officers. Downey's stock of goods was transferred to the corporation[1] on credit, which was extended from time to time. He leased space in the store building occupied by him to the corporation, which continued business at the old stand. Except for qualifying shares,[2] neither he nor the other members of his family paid cash for the stock which was issued to them[3] but received most of those shares a few months prior to bankruptcy in satisfaction of the balance of the obligation owed to him by the corporation.[4] Respondent extended credit

[1] A notice of the intended sale was recorded under the California Bulk Sales Law. Civil Code, § 3440.

[2] The shares had a par value of $100. Downey apparently paid $500 in cash for the qualifying shares.

[3] There were 99 shares issued. On July 1, 1938, Downey caused 49 shares to be transferred to his wife and 25 shares to his son. Those transfers, according to the referee, were "entirely without consideration" to Downey.

[4] There is some dispute as to the amount of this obligation. Petitioner insists, and the findings of the referee lend some support to his view, that the stock of goods was transferred to the corporation at the inventory price—about $14,000. The court below said that it was transferred at $7,500. The corporation apparently had paid $5,000 on that obligation.

to the corporation. At the time of Downey's bankruptcy respondent's claim amounted to about $5,400 and was unsecured.

On petition of the trustee in bankruptcy, the referee issued an order to show cause directed to the corporation, Downey, his wife and son why the assets of the corporation should not be marshalled for the benefit of the creditors of the bankrupt estate and administered by the trustee.[5] Downey answered. There was a hearing. The referee found, *inter alia,* that the transfer of the property to the corporation was not in good faith but was made for the purpose of placing the property beyond the reach of Downey's creditors and of retaining for Downey and his family all of the beneficial interest therein; that the stock was issued in satisfaction of Downey's claim against the corporation, when Downey was hopelessly insolvent, to prevent Downey's creditors from reaching the assets so transferred; that the corporation was "nothing but a sham and a cloak" devised by Downey "for the purpose of preserving and conserving his assets" for the benefit of himself and his family; and that the corporation was formed for the purpose of hindering, delaying and defrauding his creditors. The referee accordingly ordered that the property of the corporation was property of the bankrupt estate and that it be administered for the benefit of the creditors of the estate. That order was entered on April 7, 1939. No appeal from that order was taken.

Respondent, who was not a party to that proceeding, later filed its claim stating that as a creditor of the corporation it had a prior right to distribution of the funds in the hands of the trustee received from the liquidation of the assets of the corporation. It secured an order to show cause why the trustee should not so apply such funds. The trustee objected to the allowance of the claim as a prior claim and contended that it should be allowed only as a general unsecured claim. There was a hearing. The referee found that respondent with knowledge of Downey's indebtedness was instrumental in getting him to form the corporation and had full knowledge of its fraudulent character. He disallowed respondent's claim as a prior claim but allowed it as a general unsecured claim. That order was confirmed. On appeal, the Circuit Court of Appeals reversed, holding that respondent's claim should be accorded

[5] Shortly after the adjudication the receiver, pursuant to a stipulation, took possession of the property of the corporation.

priority against the funds realized from the liquidation of the corporation's property. 114 F. (2d) 49. We granted the petition for certiorari because of the importance in administration of the bankruptcy act of the questions raised.

We think the Circuit Court of Appeals was in error.

1. The order entered in the summary proceedings against Downey, his wife, his son and his family corporation was a final order binding as between the parties. There can be no question but that the jurisdiction of the bankruptcy court was properly exercised by summary proceedings. The circumstances are many and varied where an affiliated corporation does not have, as against the trustee of the dominant stockholder, the status of a substantial adverse claimant within the rule of *Taubel-Scott-Kitzmiller Co., Inc.* v. *Fox*, 264 U. S. 426. The legal existence of the affiliated corporation does not *per se* give it standing to insist on a plenary suit. *In re Muncie Pulp Co.*, 139 Fed. 546; *W. A. Liller Bldg. Co.* v. *Reynolds*, 247 Fed. 90; *In re Rieger, Kapner & Altmark*, 157 Fed. 609; *In re Eilers Music House*, 270 Fed. 915; *Central Republic Bank & Trust Co.* v. *Caldwell*, 58 F. (2d) 721; *Commerce Trust Co.* v. *Woodbury*, 77 F. (2d) 478; *Fish* v. *East*, 114 F. (2d) 177. Mere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket. Whatever the full reach of that rule may be, it is clear that a family corporation's adverse claim is merely colorable where, as in this case, the corporation is formed in order to continue the bankrupt's business, where the bankrupt remains in control, and where the effect of the transfer is to hinder, delay or defraud his creditors. *In re Schoenberg*, 70 F. (2d) 321; *In re Berkowitz*, 173 Fed. 1013. And see Glenn, Liquidation, §§ 30-32. Cf. *Shapiro* v. *Wilgus*, 287 U. S. 348. Hence, Downey's corporation was in no position to assert against Downey's trustee that it was so separate and insulated from Downey's other business affairs as to stand in an independent and adverse position. Furthermore, there was no appeal from the order entered in the summary proceedings. It therefore could not be collaterally attacked in the proceedings by which respondent sought priority for its claim.

2. That conclusion, of course, does not mean that the order consolidating the estates did, or in the absence of the respondent as a party, could determine what priority, if any, it had to the corporate assets. *In re Foley*, 4 F. (2d) 154. All questions of fraudulent conveyance aside, creditors of the corporation normally would be entitled to satisfy their claims out of corporate assets prior to any participation by the creditors of the stockholder. *In re Smith*, 36 F. (2d) 697. Such priority, however, would be denied if the corporation's creditors were parties to a fraudulent transfer of the stockholder's assets to the corporation. Furthermore, where the transfer was fraudulent or where the relationship between the stockholder and the corporation was such as to justify the use of summary proceedings to absorb the corporate assets into the bankruptcy estate of the stockholder, the corporation's unsecured creditors would have the burden of showing that their equity was paramount in order to obtain priority as respects the corporate assets. Cf. *New York Trust Co.* v. *Island Oil & Transport Corp.*, 56 F. (2d) 580. The power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307; *Pepper* v. *Litton*, 308 U. S. 295; *Bird & Sons Sales Corp.* v. *Tobin*, 78 F. (2d) 371. But the theme of the Bankruptcy Act is equality of distribution. § 65-a; *Moore* v. *Bay*, 284 U. S. 4. To bring himself outside of that rule an unsecured creditor carries a burden of showing by clear and convincing evidence that its application to his case so as to deny him priority would work an injustice. Such burden has been sustained by creditors of the affiliated corporation and their paramount equity has been established where there was no fraud in the transfer, where the transferor remained solvent, and where the creditors had extended credit to the transferee. *Commerce Trust Co.* v. *Woodbury, supra.*

But in this case there was a fraudulent transfer. The saving clause in 13 Eliz. which protected innocent purchasers for value[6] was not broad enough to protect mere unsecured creditors of the

[6] See Clements v. Moore, 6 Wall. 299; Harrell v. Beall, 17 Wall. 590. That the same result follows in absence of the saving clause see Astor v. Wells, 4 Wheat. 466, interpreting L. Ohio, 1809-10, ch. LVII, § 2. And see 1 Glenn, Fraudulent Conveyances and Preferences (1940) § 237.

fraudulent transferee. *Clark* v. *Rucker*, 7 B. Mon. (Ky.) 583; *Mullanphy Savings Bk.* v. *Lyle*, 75 Tenn. 431; *Powell* v. *Ivey*, 88 N. C. 256; *Lockren* v. *Rustan*, 9 N. D. 43, 45. To be sure, creditors of a fraudulent transferee have at times been accorded priority over the creditors of the transferor where they have "taken the property into their own custody". 1 Glenn, Fraudulent Conveyances and Preferences (1940) § 238. Cf. *O'Gasapian* v. *Danielson*, 284 Mass. 27. The same result obtains in case of *bona fide* lien creditors of the fraudulent transferee. *W. T. Rawleigh Co.* v. *Groseclose*, 174 Okl. 193; *Plauche* v. *Streater Investment Corp.*, 189 La. 785. Cf. *Haskell* v. *Phelps*, 191 Wash. 567. And estoppel or other equitable considerations might well result in the award of priority even to unsecured creditors of the transferee, the conveyance being good between the parties.[7] Cf. *Kennedy* v. *Georgia State Bank*, 8 How. 586, 613. Yet none of these considerations is applicable here. The facts do not justify the invocation of estoppel against Downey's individual creditors. Respondent is neither a lien creditor nor an innocent grantee for value. At best it is in no more favorable position than a judgment creditor who has not levied execution. Furthermore, respondent had at least some knowledge as to the fraudulent character of Downey's corporation. Cf. *Goodwin* v. *Hammond*, 13 Cal. 168; *Bull* v. *Ford*, 66 Cal. 176. And title to the property fraudulently conveyed has vested in the bankruptcy trustee of the grantor. We have not been referred to any state law or any equitable considerations which under these circumstances would accord respondent the priority which it seeks. It therefore is entitled only to *pari passu* participation with Downey's individual creditors. *Buffum* v. *Barceloux Co.*, 289 U. S. 227.

The judgment of the Circuit Court of Appeals is reversed and that of the District Court affirmed.

It is so ordered.

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[7] All question of the rights of creditors of the grantor aside, creditors of the transferee have at times been alowed to reach the property after its reconveyance to the grantor. Chapin *v.* Pease, 10 Conn. 69; Budd *v.* Atkinson, 30 N. J. Eq. 530; Hegstad *v.* Wysiecki, 178 App. Div. 733. But see Farmers' Bank *v.* Gould, 48 W. Va. 99; Westervelt *v.* Hagge, 61 Neb. 647; Bicocchi *v.* Casey-Swasey Co., 91 Tex. 259.